

Statement of
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a member of
The Hay Group
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Committee on Post Office and Civil Service
of the
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TESTIMONY FOR THE
COMMITTEE ON POST OFFICE AND CIVIL SERVICE

Mr. Chairman, and members of the Committee, my name is Kenneth Shapiro, President of Hay/Huggins consulting actuarial firm. I have with me Mr. Edwin Hustead, Vice President of Hay/Huggins, and Mr. Gregori Lebedev, Director of Governmental Consulting Services of Hay Associates. We are honored to appear before the Committee on Post Office and Civil Service to lead off the public hearings on the development of a new retirement system for Federal employees who are also covered by Social Security. As you are aware, Hay/Huggins is involved in an extensive analysis of this issue for the Committee and we look forward to working with you in designing the new retirement system. This new retirement system should not only well serve the retirement needs of Federal employees, but also could become a model for employers outside the Federal Government.

Background

First some background. Public Law 98-21, enacted in April of 1983, lead to the need for the establishment of a new Federal retirement system for certain employees. That law provided that all new employees hired after January 1, 1984 would be covered by Social Security. The legislation also requires the coverage of a few specific people, such as the President and Members of Congress--even if they were covered by the Civil Service Retirement System before 1984. The law itself did not require a new system, but because of it a new system clearly is needed.

As with most new retirement systems, the employer, in this case the Federal Government, has a transition period to consider and implement the best possible plan. Although there will not be a large number of retirements under the new system for several decades, continuation of the current situation would have required double contributions from new Federal employees--one to Social Security and one to an undefined new Federal retirement system. Also, both systems would affect those relatively few new employees who might die or become disabled in the next year.

To avoid these near term problems, the Congress passed Public Law 98-168. This law solves the problem of double contributions or double benefits pending development of a new system. But PL98-168 expires at the end of the calendar year 1985--leaving us ample, but not excessive time to create a new system.

The design of the new Federal retirement system will be a landmark effort. In recognition of both the critical importance to those who will be covered, as well as the possible extension of the concept outside of the Government, the Committee has decided to take a considered and detailed approach to its design. Hay/Huggins is pleased to assist the Committee along with the Congressional support agencies--in particular, the Congressional Research Service.

Basic Concepts

Our purpose this morning is to describe some basic concepts about the coordination of Civil Service Retirement with Social Security benefits and suggest the proper approach in designing a new system. Let me first summarize the various studies that now are underway.

Hay/Huggins now is conducting two studies that define the prevalence and type of fringe benefit and total compensation systems in the public and private sectors. Our study will

summarize and evaluate each of the important provisions of the compensation systems with a particular focus on retirement.

The Congressional Research Service has two studies underway for the Committee. The first will compare cost and other provisions of the CSRS with typical pension arrangements in the private sector and by State governments. The second CRS report will analyze program design features, cost, and replacement rates for several options for the new pension system. We have been privileged to join with CRS in five briefings to the staff of the Committee on the concepts and issues involved and anticipate quite a few more briefings as the work proceeds.

In addition to the studies being done for your Committee, the Congressional support agencies have been asked by the Senate Committee on Governmental Affairs to undertake a coordinated study of the issues in designing a new pension system. The General Accounting Office is doing an indepth analysis of retirement practices both in the private sector and by State and local governments. To determine exactly how retirement systems have been set in place, the General Accounting Office is also interviewing large private sector employers. The Congressional Budget Office is estimating the budgetary and economic impacts of proposed changes against the current system's structure, financial condition, and investment policy.

In addition to the efforts directed by Congress, there are a number of studies that are taking place both in and outside of Government. For instance, the Office of Personnel Management has contracted for an analysis of retirement systems in the private sector, hoping to apply these findings to development of retirement options for all employees covered by CSRS. Congress already has in hand the analysis by the President's Private Sector Commission on Cost Control and we understand that other business groups are studying the issue.

As a result of all these and other studies there will certainly be enough data and analysis on which to base your decisions. However, analysis is only helpful if it is brought to bear on the issue. After the studies are completed, the role of Hay/Huggins will be to help focus the effort of the Committee. Our aim is to help sort out all the options, allowing the Committee to create the most viable system.

In the remainder of today's testimony, we will present basic information on the issues and discuss the methods that the Committee might use to develop and implement a fair and equitable retirement system for new Federal employees.

Social Security and CSRS

One of the major objectives of a new system will be to combine the benefit design of the current Civil Service Retirement System with the Social Security system. As the Committee is well aware, these two systems are both necessarily very complex. Integrating them will be difficult.

Our first chart displays the key differences between the Civil Service Retirement System and Social Security. Here we will find areas that will be the most difficult to integrate.

Benefit as Percent of Pay

First, the Social Security system is intended to provide a floor of retirement income to employees. Consequently, although the Social Security benefit increases as length of employment increases, it does so at a progressively slower rate. In the Civil Service Retirement System, on the other hand, the benefit increases proportionately to salary and more than proportionately to service.

The results can be illustrated by looking at short and long service employees. Long service employees under CSRS receive a

KEY DIFFERENCES BETWEEN THE CIVIL SERVICE RETIREMENT SYSTEM AND SOCIAL SECURITY

| | <u>CSRS</u> | <u>Social Security</u> |
|--|------------------------------------|------------------------|
| Benefit as Percent of Final Pay | | |
| — 35 Years' Service | 60% to 63% | 40% to 19% |
| — 10 Years' Service | 5% to 15% | 20% to 10% |
| Earliest Unreduced Retirement Age and Service | 55 and 30 60 and 20 62 and 5 | 65 to 67 and 10 |
| Earliest Reduced Retirement | Only for Involuntary Retirement | 80% or Less at Age 62 |
| Disability Requirement | Comparable Job | Any Job |
| Portability | Conditional Vesting | Full Portability |
| Family Benefits | | |
| Surviving Spouse | Yes | Yes |
| Divorced Spouse | No | Yes |
| Living Spouse | No | Yes |

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the same 61% of salary at retirement at all salary levels. With the same amount of service under Social Security, the lower-paid employees will receive 40% of pay. But the higher-paid will receive 19% or less of pay as their retirement income. For short service, CSRS only provides around 15% of pay if the service is rendered right before retirement. If the service is rendered in the early part of the career, the benefit loses value over the years, and the final benefit may be worth 5% or less of the final pay. Social Security, on the other hand, provides 20% to 10% of pay for 10 years' service. Not as much as for a full career but still more than the proportionate share of the career.

Retirement Benefit Eligibility

The actual level of benefit provided at retirement under Civil Service Retirement is typically less than the total benefit provided for a full career when you add the benefits of private sector plans with Social Security benefits. However, the CSRS system is more liberal in certain areas. One of the key distinctions of CSRS is its allowance for full retirement benefits at age 55. But we must keep in mind that the employee needs 30 years of service. Few employees work from age 25 to 55 for one employer. The other requirements, which are much easier to meet, are retirement at age 60 with 20 years of service or age 62 with 5 years of service. Social Security now requires an employee to wait until 65 for full benefits. Under the 1983 legislation, the retirement age will move gradually up to age 67. Employees will still be able to retire at 62, but the 20% reduction that applies now will gradually increase in subsequent years.

Disability

A third area of difference is in the definition of disability. As with many private sector systems, at least in the short run, a Federal employee is considered disabled if he or she is unable to perform a job comparable to the current job. Social Security will

only pay benefits after six months and then only to people who are considered totally and permanently disabled to perform any job.

Portability

Now that Social Security coverage is practically universal in the United States, benefits are fully portable from employer to employer. This contrasts sharply with the CSRS requirement that the employee must serve five years to vest and then that the benefit will lose value before retirement because there is no adjustment for inflation. That benefit can even be forfeited if the employee elects a refund of contributions.

Dependent Definition

A final important difference is in the way each system defines a dependent eligible for a benefit. Both will pay a benefit to a surviving spouse or child but, in the case of CSRS the benefit must be partially paid for by the employee. Social Security also provides benefits to a divorced spouse who meets certain conditions. It also pays benefits to living spouses and other dependents. Neither of these benefits is provided by Civil Service Retirement.

Categories of Plans

There are three important sources of income. The first source is Social Security that is required of all private sector employees and now will be required for all new Federal employees. The second source is the retirement plan offered by the employer. The third is the contribution from the savings of the employees. The general categories of employer retirement systems are summarized in the following table.

There are two major categories of employer retirement plans in common use in the United States. Defined benefit plans

TYPES OF RETIREMENT SYSTEMS AVAILABLE

- **Defined Benefit Plan**

Add-On

Offset

Step Rate

- **Defined Contribution Plan**

Add-On

Step Rate

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provide a promised level of benefit at the point of retirement. For instance, an employer might promise to provide 1.5% of the average of the final five years' salary for each year of service with the employer. Thus, a twenty year employee with a final five year average of \$30,000 would receive 30% of this average or \$9,000 per year. The other approach is to provide a defined contribution to an investment fund. For instance, an employer might provide 10% of each year's pay to an employee. This is placed in a fund, with the fund and its investment income used to provide a retirement income.

In a defined benefit program, the employer is at risk; he or she must pay a prescribed benefit--even if the pension fund has not performed as expected. In a defined contribution plan, the employee is at risk. He or she gets less than expected if fund performance is low. In both cases, of course, the converse is true if the fund performs better than expected.

Currently, of the 854 participants in the 1983 Hay/Huggins Benefits Comparison, 86% use a defined benefit plan. Most of these companies are supplementing this plan with an additional defined contribution program.

The current Civil Service Retirement System operates strictly as a defined benefit plan. For instance, the current Civil Service Retirement benefit formula provides 56 1/4% of high-three average pay to employees who have served 30 years. Through the use of the increasing pay base, the benefits are indexed to inflation before retirement, and, through a guarantee of cost-of-living protection, the benefits are indexed after retirement. Among our survey participants, 84% base the retirement benefits on a percentage of final average pay so the indexing before retirement is also covered. But of the 57% of our survey participants that provided any indexing after retirement, 84% provide it on an ad hoc basis and, in virtually all cases, at levels below the full rate of inflation.

Advantages and Disadvantages of Defined Benefit vs. Defined Contribution Plans

Certain apparent advantages of the defined contribution type of plan have led to proposals to change CSRS to that type of system. First, the defined contribution plan moves the burden of inflation from the employer to the employee. For instance, in the other alternative--defined benefit plan--an employer might be faced with a period of inflation that pushes salaries beyond initial expectations. The contribution of earlier years then provides inadequate funding for the pension payout that is based on inflated salaries. In the defined contribution plan, employers know their cost--a flat percentage of salary--with no penalty if inflation goes higher than expected.

Another advantage of the defined contribution plan is its simplicity. The benefit is merely the percentage of pay that is contributed. Thus the benefit that the employee receives depends on the fund balance, not on some future calculation. Further, because the plan is based simply on a contribution rate, many of the complex provisions of the Employee Retirement Income Security Act and Internal Revenue Service Code are not applicable. This administrative convenience is thus attractive, especially to the small employer.

However, the simplicity of the defined contribution approach imposes a certain rigidity. In a defined contribution plan it is difficult, but not impossible, to fund reasonable benefits for people who do not participate for a full career because they die, become disabled, or otherwise leave employment. In a defined benefit plan any of these contingencies can be met with a specifically defined formula.

The choice between the two systems comes from the confluence of economic, social and administrative considerations. In the past, larger employers have chosen the defined benefit approach

to provide the security that the employee perceives from its guarantee of a certain benefits level. The defined benefit plan also allows the employer more flexibility in design and funding.

Our 1983 Hay/Huggins survey shows that 86% of employers provide defined benefit plans. In our 1979 survey, a comparable number was 91%. This suggests a trend away from defined benefit plans.

Integration with Social Security

Once the general type of plan is selected, the next question is: To what degree do you integrate it with Social Security benefits? As the first line of retirement protection, Social Security is designed not only to provide retirement income based on salaries earned while working, but also to provide a minimum level of retirement income for all employees. As we have seen, the Social Security benefit provides a much higher percent of pay for low-paid employees than for those who are high-paid. As mentioned above, most Federal employees will retire in the \$15,000 to \$45,000 final pay range. At the lower end of the range, Social Security will provide 40% of pre-retirement income but at the higher end only 19% of pre-retirement income.

~~The employer must consider the extent to which the tilt of~~ the Social Security benefit should be offset by the employer's pension plan formula. A straightforward approach would be simply to state that a certain percentage of salary will be provided to the employee with the benefit fully offset if and when Social Security benefits become payable. For instance, the new retirement system for new employees could be constructed to provide the same 56 1/4% income to employees at age 55 with 30 years of service as under CSRS. When Social Security benefits begin at age 62 these Civil Service benefits would be reduced dollar for dollar by Social Security benefits. Thus, the new employees would be covered by a system that was largely identical to the system for current Federal employees.

The private sector employer who wants to use such a full offset is, however, prevented from doing so by Federal regulations. An underlying philosophy, reflected in rules imposed by the IRS on the private sector, in return for the privilege of insulating pension funds from taxes, is that benefits should not be proportionately greater for higher-paid employees than for lower-paid employees. An exception is allowed to offset some, but not all, of the Social Security offset tilt. The law and regulations in this area are very complex, but the practical limit, used by three-quarters of the employers who have such a system, is to offset half of the Social Security benefit.

The next chart shows the various methods of integrating a pension plan with Social Security. The first line differentiation is the benefit from Social Security of 21% of pay across the range of most Federal salaries. The Committee could simply accept this differentiation and provide an add-on plan with employer benefits that are the same percentage for all employees, thus, preserving the full tilt of Social Security benefits. At the other extreme, the Committee could offset all of the Social Security benefit but this would violate Congress' own rules for the private sector. By using the typical factors in the private sector, as required by IRS regulations, the Government could use an offset or step-rate approach to remove half of the tilt, thus, leaving a 10% difference between the high and low-paid employees.

The analysis done by Hay/Huggins and the Congressional Research Service will fully examine the effect of differentiation. While a full offset may be desirable to be consistent with the current plan, and the Congress could except the plan from IRS rules, Congress may believe that such an exception is not politically or morally desirable and may thus want to focus on the partial offset options.

The choice of the degree of differentiation between the benefit for the high and low-paid employees will center primarily

ILLUSTRATION OF DOLLAR BENEFITS UNDER AVAILABLE RETIREMENT SYSTEMS

| | <u>Final Pay \$15,000</u> | <u>Final Pay \$45,000</u> |
|--------------------------|-------------------------------|-------------------------------|
| Social Security | \$ 6,000 | \$ 8,750 |
| Add-On Formula | \$ 4,800 | \$14,400 |
| Offset Formula | | |
| — Unreduced Benefit | \$ 7,200 | \$21,600 |
| — Offset | \$ 3,000 | \$ 4,375 |
| — Total | \$ 4,200 | \$17,225 |
| Step-Rate Formula | | |
| — For Pay Under \$15,000 | \$ 4,200 | \$ 4,200 |
| — For Pay Over \$15,000 | \$ 0 | \$13,200 |
| — Total | \$ 4,200 | \$17,400 |

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ILLUSTRATION OF REPLACEMENT INCOME UNDER AVAILABLE RETIREMENT SYSTEMS

| | <u>Final Pay \$15,000</u> | <u>Final Pay \$45,000</u> |
|--------------------------|-------------------------------|-------------------------------|
| Current CSRS Plan | 61% | 61% |
| Social Security | 40% | 19% |
| Add-On Formula | 72% | 51% |
| Offset Formula | 68% | 58% |
| Step-Rate Formula | 68% | 58% |

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on two facts. First, the existing Civil Service Retirement System provides all employees with the same age and service with the same percentage of pay from the total retirement system. On the other hand, studies have shown that low-paid employees actually need a much higher proportion of retirement income than high-paid employees to maintain their existing standard of living. For instance, the President's Commission on Pension Policy showed that a 15% differentiation between the high and low-paid employee is needed to continue comparable standard-of-living levels after retirement. This is primarily the result of the favorable tax treatment of income to the elderly--particularly on Social Security income.

Plan Details

Settling the questions of what type of plan to use and how to integrate it with Social Security are the first steps in developing a complete retirement system. Each of the following important plan provisions are also critical. These include:

- o Definition of full career retirement
- o Definition of early retirement
- o Benefit for early retirement
- o Eligibility for disability benefits
- o Amount of disability benefit
- o Eligibility for survivor and family benefits
- o Amount of survivor and family benefit
- o Eligibility for vested benefits
- o Amount of vested benefit
- o Inflation protection

Full Career Retirement

As we have noted, a key provision of the current Civil Service Retirement System is full retirement at age 55 with 30 years of service. This has become the focus not only of concerned Federal employees who at mid-career are anticipating retirement at age 55, but also of critics who point to this as an atypically low retirement age. The Committee needs to carefully consider what a career is in the terms of the Federal Government and when full "retirement" should occur. When reviewing this matter with the Committee, we will look not only at the retirement ages in the private sector but at recent analyses such as that of the Quadrennial Review of Military Compensation (QRMC). This review suggests that different career patterns make sense in different environments.

Early Retirement

Although full private sector retirement benefits often are not payable until age 62 or age 65, age 55 is commonly the earliest age at which reduced benefits are available. But age 55 retirement in the private sector virtually always involves a reduced benefit, commonly between 33% and 50%.

The other benefits areas address the fair and equitable treatment of employees who do not complete a full career. If the absence of a full career is due to an unexpected occurrence beyond the control of the employee, primarily death or disability, there is often a need to alter the usual eligibility requirements and adjust the amount of the benefit. The Civil Service Retirement System currently includes a number of provisions that address this social desirability of providing reasonable benefits upon either death or disability. However, because many of these benefits are provided in the Social Security system, the new system may need to provide less.

Disability

In the event of disability, it is essential not only to look at the disability benefits of the pension plan, but also at sick leave and other disability programs. The current Civil Service Retirement System does provide benefits to some people who would not meet the Social Security definition of disability. However, employers often achieve the same results by offering a separate long-term disability plan; typically the benefits provided are substantially higher than other Civil Service Retirement. The Committee should look at the full range of benefits--from all disability programs as well as from the sick leave program. To provide a continuous and equitable level of income for people who are truly disabled, it is important that all of these programs dovetail. Options also exist to differentiate the benefits for employees who are unable to perform their current job from those who are so severely disabled that they cannot perform any work.

Death

The second major type of unexpected occurrence is death. If an employee dies before a full career, to what extent should the employee's surviving spouse and children be provided additional benefits? As with disability, much of this type of protection is provided through the Social Security system and through programs such as the Federal Employees Group Life Insurance program.

The new system design also needs to respond to changing family characteristics. Both the CSRS and Social Security, as well as most private sector systems, were originally designed to provide benefits to a male employee with a nuclear family. In recent years this pattern has changed dramatically; often both parents work and many people are married more than once during their working career and/or after retirement. The needs of each of the current and former spouses must be considered.

Vesting and Portability

While the retirement system should provide reasonable income for every career employee, and those who die or become disabled in service, it should also provide reasonable income for a partial career. When a partial-career benefit is combined with benefits from other employment, the total retirement income should meet expectations and needs. This goal is met through appropriate vesting and portability conditions. In examining various service career patterns, we must look at the effect of a common cause for career interruption: pregnancy and subsequent childrearing responsibilities. It is thus particularly important that the total benefit over a lifetime be adequate for employees with shortened or split careers.

Inflation Protection

The final important need is to develop some degree of protection against inflation after retirement. In theory, a level of income that is considered reasonable at retirement should be indexed to guarantee a consistent standard of living after retirement. Private sector employees receive Social Security, which is fully indexed, and, as mentioned above, most of the employers in our survey provide ad hoc inflation protection. A study of the Congressional Budget Office shows that as a result the average private sector retiree receives benefit increases equal to 70% of inflation.

Approach

Hay/Huggins' effort to assist the Committee is consistent with the approach we would use with a large private sector employer. The next chart summarizes that approach. When an employer is installing or redesigning a retirement system, it is important to look at all of the factors that will affect the employer and the employees.

APPROACH TO THE DESIGN OF RETIREMENT PLAN FOR FEDERAL EMPLOYEES COVERED BY SOCIAL SECURITY

- **Survey Plans Provided by Competitor Organizations**
- **Survey All Compensation Elements Provided by Competitor Organizations**
- **Analyze the Effect of Each Plan Design**
 - **Cost to Employer**
 - **Benefit to Employee**
 - **Effect on Workforce**
 - **Ease of Understanding**
- **Focus All Data and Analysis to Produce Most Desirable Plan**
- **Implement Plan**

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Competitive Analysis

Our starting point for the Committee, as with a private sector employer, will be to look at prevailing practices among various types of employers. It is important to have a total compensation system, including a retirement system, that allows the employer to attract, retain and motivate the type of employee that will best serve the organization. The retirement system should also allow the employer to move employees through the workforce both to maintain continuity and to provide the best employees with opportunities to move ahead.

To address the question of attracting, retaining and motivating good people, it is essential to look at the compensation practices provided by other employers. To gather this broad perspective we will use data from all of the employers in our data base; 854 in the Hay/Huggins Benefits Comparison (HHBC) and 1,249 in the Cash Compensation Comparison. We will examine the total cash compensation of comparable positions within each organization and then convert all of the benefit packages to cash equivalents to arrive at figures that allow us to compare total compensation practices. This unique overall picture allows the employer to see the total compensation package from the point of view of the people that the employer is seeking to attract and retain.

We will augment the total compensation overview with an analysis of each individual compensation element. In particular, we will focus on the value of the retirement system both in the general context of the plan and for each specific provision--such as benefits provided for full career retirement, disability or death.

Cost

After viewing the options available, the Committee will meet to look at the cost of each option. An employer may well wish to

have a plan that will attract and retain the best employees and ensure that the employees are paid salary and benefits that are comparable with the competition. But this same employer may be unable to afford the package. It is also important to consider allocation of costs between the parts of the total compensation package. For instance, an employer may well wish to encourage career employees to stay for 30 years or more; therefore, emphasize benefits at the expense of cash compensation. Within the benefits package, the employer may wish to emphasize retirement.

Benefits to Employees

The final step in the background analysis will be to look at the range of benefits provided to different categories of employees. The employer may well set a benefit package that has the desired overall cost and level of competitiveness. But this may result in paying certain employees too much and others too little. It is important to look at employees in different salary levels, examine short and long service careers, and compare disability and death benefits to those offered at retirement. Although there may be justifiable differences in benefits among employee groups, these differences should be fully understood by the employer.

Effect on Workforce

It is important to design a plan that will attract, retain and motivate those employees necessary to perform the tasks of government employment. For example, a different plan would be installed if it was desirable to attract short versus long service employees..

Simplicity of Formula

Finally, it is important to keep the benefit formulae as simple as possible to promote employee understanding and minimize administrative costs.

Plan Design

After the information is gathered and presented to the Committee by Hay/Huggins and the Congressional Research Service, we will help the Committee use this information to develop a retirement system. A wealth of this data will be gathered both on pension practices in the United States and the application of these practices to the Federal Government. However, this data must be distilled and put in the perspective of the Federal Government. We envision a series of discussions and hearings to develop the most viable system for new Federal employees.

As with a private sector employer, the first question will be the appropriate type and mix of pension plan or plans and Social Security. Any retirement system must build on the base of the Social Security system and integrate with that system to the extent desired by the Government and needed by the employees. The retirement dollars might best be shared between a defined benefit and defined contribution plan. This would result in shifting some of the risk of inflation to the employee, without putting the total risk on him or her. It also would encourage the third leg of retirement income--the employee's own savings.

In designing this new system, Hay/Huggins will help the Committee to bring together three distinct analytic processes. First is the comparison of the program to the programs available among competitors in the private and public sectors. Second is the overall analysis of cost to the Government; and third is a valuation of the replacement income that will be available to various individuals. A less data intense, but vitally important, analysis will subjectively consider the effect of a new system on the attraction and retention of the Federal workforce.

Comparison to Private Sector

The next chart illustrates the result of the decisions made by the 854 firms in our survey. When all sources are considered,

COMPARISON OF RETIREMENT BENEFITS: CIVIL SERVICE AND PRIVATE SECTOR

| | <u>CSRS</u> | <u>Private Sector</u> |
|--|------------------------------------|--|
| 35 Year Benefit as Percent of Pay | 60% to 63% | 80% to 66% |
| Earliest Unreduced Retirement Age and Service | 55 and 30 60 and 20 62 and 5 | 62 or 65 and 10 |
| Earliest Reduced Retirement | Only for Involuntary Retirement | 50% to 70% of Full Benefit at Age 55 |
| Disability Benefits | Minimum of 40% of Pay from Pension | 60% to 75% of Pay from Pension, Insurance, and Social Security |
| Cost-of-Living Protection | Full | Full for Social Security; Partial for Half of Pension Plans |
| Supplementary Capital Accumulation Plans | None | Half have Plans |
| Contribution | 7% to CSRS | 7% to Social Security Plan; 3% to Capital Accumulation |

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private sector firms typically provide a full career benefit of 66% to 80% of final pay--this by combining the private sector pension and capital accumulation plans with Social Security.

Retirement Age

The private sector plans are split evenly between those that permit the earliest full retirement age at 65 and those that use age 62. However, 89% of the employers allow retirement at age 55 usually with a requirement of 10 years of service. Thus, the general practices are not much different than the Civil Service Retirement System. However, in the private sector the early retirement benefit at age 55 is usually reduced from one-third to fifty percent of the full benefit.

COLA

Cost-of-living increases are granted in full under the Social Security system. In the private sector, over half of the larger employers provide ad hoc cost-of-living increases which typically are 3% per year of retirement. The combination of these increases protect employees against approximately 70% of inflation.

Disability

In the area of disability benefits an employer will typically rely on a range of plans. The employer will use a sick leave or short-term plan to take care of the short-term disabilities and a long-term disability plan and/or the pension plan to provide long-term income. Of course, they all have an underlying Social Security program that provides 40% to 19% of pay for those who are disabled.

Post-Retirement Survivor Benefits

In the area of survivor benefits, the private sector firms do provide insurance to employees; often this continues into retirement, as it also does in Federal Employees Group Life Insurance. However, private sector employers generally leave the basic survivor and family benefits to the Social Security program. Although annuitants are free to select a survivor benefit in the pension plan, usually they have to pay the full cost of this benefit through reductions in their retirement annuities. *Handwritten: agreed*

Uniqueness of Federal Government Situation

While the private sector perspective is important, it should not mask the unique aspects of the Federal environment. Primary among these is the fact that the Federal Government is selecting a design to fit around Social Security for the first time. Employers in the private sector have not been faced with the need to design a new system to fit around Social Security for over forty years.

A second unique aspect is the place of the retirement accounts in the Federal budget. In the private sector the employer allocates money each year during the employee's working career to pay for the retirement benefit. This is the bottomline cost of the employer's budget. Within the Unified Budget of the Federal Government, however, money cannot be isolated effectively from the budget before the employee retires and receives the benefit. The effect on the budget in each year is the income received from employees less the retirement income and refunds paid. Thus, the typical private sector approach is important as a relative cost but is not the key budget item.

Finally, the employees hired before January 1, 1984 and annuitants are understandably concerned about the financing of

the current system. The current CSRS financing was constructed in 1969 to provide enough income on a going concern basis. As long as new employees enter the system, the payments will be sufficient to cover future benefits. However, if the current system is closed, this flow of fresh money will cease and the fund will disappear before all of the promised benefits are paid.

Fortunately, there are solutions to the funding problem that will not have important budgetary consequences. First of all the new law could simply be set up as a separate plan within the current law. The current law already covers five different subsystems and there are annuitants who retired under many different prior subsystems. Therefore, there are already a number of different benefit categories within the CSRS system. Similarly, the new benefits could be covered in the current CSRS financing system through a simple change in the current law.

A second approach to stabilizing the funding that would not have any effect on the budget would be to simply amortize the current unfunded liability in time to avoid depletion of the fund. Because under the Unified Budget payments from general revenues to the trust funds are intragovernmental transactions that do not affect the deficit, this could be done without affecting the deficit or surplus.

I appreciate your attention and look forward to working very closely with the Committee in the future.